Supreme Court
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No. 98-380

In The

Supreme Court of the United States

October Term, 1998

BANK ONE, MILWAUKEE, N.A.,

Petitioner,

v.

P.A. BERGNER & CO.,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

REPLY BRIEF FOR PETITIONER

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14pp

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

ARGUMENT 1

CONCLUSION 10

TABLE OF AUTHORITIES

Page

CASES

In re Finn, 909 F.2d 903 (6th Cir. 1990) 7, 8

In re Fuel Oil Supply & Terminaling, Inc., 837 F.2d 224 (5th Cir. 1988) 2, 3, 4, 6

In re Jones Truck Lines, Inc., 130 F.3d 323 (8th Cir. 1997) 6

In re Milwaukee Cheese Wisconsin, Inc., 112 F.3d 845 (7th Cir. 1997) 7, 9

In re Molded Acoustical Products, Inc., 18 F.3d 217 (3d Cir. 1994) 9

Molzof v. United States, 502 U.S. 301 (1992) 5

Morisette v. United States, 342 U.S. 246 (1952) 5

In re Morren Meat & Poultry Co., 92 B.R. 737 (W.D. Mich. 1988) 8

In re Peterson Distributing, Inc., 197 B.R. 919 (D. Utah 1996) 8

In re Powerine Oil Co., 59 F.3d 969 (9th Cir. 1995), *cert. denied*, 516 U.S. 1140 (1996) 6

In re Roblin Industries, 78 F.3d 30 (2d Cir. 1996) 7, 8, 9

In re Tolona Pizza Products Corp., 3 F.3d 1029 (7th Cir. 1993) 7, 9

In re U.S.A. Inns of Eureka Springs, Arkansas, 9 F.3d 680 (8th Cir. 1993) 8, 9

TABLE OF AUTHORITIES – Continued

Page

STATUTES

11 U.S.C. § 547(c) 9, 10

11 U.S.C. § 547(c)(1) 1, 2, 5

11 U.S.C. § 547(c)(2) 1, 8, 9

11 U.S.C. § 553(b) 9

MISCELLANEOUS AUTHORITIES

Ponoroff, *Evil Intentions and An Irresolute Endorsement for Scientific Rationalism: Bankruptcy Preferences One More Time*, 1993 Wisc. L. Rev. 1439 6

Restatement (Second) of Contracts (1981) 5

REPLY BRIEF FOR PETITIONER

Contrary to Bergner's suggestion, this is no "ordinary preference action" (Opp. 1). Because of the decision below, Bergner stands to recover not only the $37 million in future goods and services provided to it by AMC and Liberty Mutual, but also the $37 million that paid for those goods and services.

In its petition for certiorari, Bank One explained that the decision below raises two important questions: first, whether the "new value" defense under 11 U.S.C. § 547(c)(1) requires a debtor to receive new value directly from the allegedly preferred creditor; and, second, whether the "ordinary course of business" defense under 11 U.S.C. § 547(c)(2) requires the existence of past similar transactions between a debtor, when it was financially healthy, and the allegedly preferred creditor. Bank One explained that the courts of appeals are divided on both of these questions (Pet. 11-16, 22-26), that the Seventh Circuit's affirmative answer to these questions conflicts with the decisions of this Court and the decisions of other courts (Pet. 16-19, 26-30), and that these questions have important and recurring significance both inside and outside the letter-of-credit context (Pet. 18, 19-20, 28-29).

In its opposition, Bergner responds only that the decision below rests on narrow factual grounds that allegedly do not implicate those substantial legal questions. But, in so seeking to justify its $37 million double recovery, Bergner itself mischaracterizes the decision below and in fact illustrates that the questions presented warrant this Court's review.

1. With respect to the "new value" question, Bergner argues that neither of the three-party transfers at issue in this case – among Bergner, Bank One, and AMC, and among Bergner, Bank One, and Liberty Mutual –

constituted an "exchange" within the meaning of 11 U.S.C. § 547(c)(1). Bergner appears to concede that, when Bank One paid AMC and Liberty Mutual under their respective letters of credit, those parties in turn provided $37 million in *future* goods (inventory from AMC) and services (insurance from Liberty Mutual) to Bergner. Opp. 12 (acknowledging "value that flowed from AMC and Liberty to Bergner"); Opp. 13 (acknowledging "the value received from AMC and Liberty"). However, Bergner contends that, because Bank One would have paid AMC and Liberty Mutual even if Bergner *hypothetically* had not paid Bank One to ensure the provision of these future goods and services, Bergner did not receive new value as the result of any statutory "exchange." Bergner advances this hypothetical causation theory both as the ground of decision below (Opp. 6-7) and as the basis for distinguishing *In re Fuel Oil Supply & Terminaling, Inc.*, 837 F.2d 224 (5th Cir. 1988) (*"FOSTI"*), and its progeny (Opp. 10-14). But Bergner's hypothetical causation theory mischaracterizes both the ground of the decision below and the basis on which the court below purported to distinguishing *FOSTI* and its progeny. Moreover, Bergner's theory is meritless on its own terms.[1]

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[1] Although Bergner does not seriously press the point, it also briefly suggests (Opp. 2-3 n.3) that the payments from Bank One to AMC and Liberty Mutual merely satisfied Bergner's existing debt for goods and services provided to Bergner in the past. That suggestion, however, ignores the record. As the lower courts explained, when Bank One paid AMC, Bergner "owed nothing to AMC," and thus received "a credit balance at AMC for goods not yet shipped." Pet. App. 30a-31a, 69a-70a. Similarly, the payments from Bank One to Liberty Mutual provided Bergner with "postpetition" insurance (Pet. App. 32a-33a, 72a) during the ten months after its August 1991 bankruptcy filing (Pet. App. 9a).

Contrary to Bergner's argument, the court below did not hold that there was no "exchange" because Bank One would have paid AMC and Liberty Mutual even if Bergner hypothetically had not paid Bank One. Rather, the court below held that the "new value" defense failed because, when Bergner made the allegedly preferential transfers to Bank One, "Bank One itself did not incur a contemporaneous corresponding obligation to Bergner." Pet. App. 19a. The court explicitly stated that such an obligation from "Bank One itself" (as opposed to AMC and Liberty Mutual) "would be necessary for the new value defense to succeed." *Id.* Bergner suggests that this holding was "perhaps inartfully phrased" (Opp. 13 n.6), but Bergner lacks any sensible explanation for supposing that the court below did not mean exactly what it said. Indeed, the "context" stressed by Bergner only reinforces the stated ground of decision that "Bank One's obligation ran independently to AMC," rather than directly to Bergner. Pet. App. 19a-20a.[2]

Likewise, the court below did not purport to distinguish *FOSTI* and its progeny on the ground that Bank One would have paid AMC and Liberty Mutual even if Bergner had not paid Bank One. In contrast to Bergner, the court below made no mention of this hypothetical causation argument. Nor did the court below mention – as does Bergner (Opp. 11) – the secured nature of the letter of credit at issue in *FOSTI*. Rather, the court below offered only two purported distinctions of this conflicting authority: first, that the parties in *FOSTI*, but not here,

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[2] Although these critical passages of the court's holding directly addressed only the AMC letter of credit (Pet. App. 19a-20a), the court later held that "the analysis of the Liberty Mutual letter of credit is identical in all relevant respects to that of AMC's" (Pet. App. 24a).

"*intended* a third party's acts to provide new value to the debtor"; and second, that the "independence principle" underlying state letter-of-credit law is "implicated" in this case, but was not in *FOSTI*. Pet. App. 20a (emphasis in original). Bergner makes no attempt to defend either of these purported distinctions. By failing to do so, and instead offering completely different purported distinctions, Bergner itself demonstrates that the decision below – as articulated by the court below – squarely conflicts with *FOSTI* and its progeny.[3]

Finally, there is no merit to the new theories that Bergner offers in defense of the decision below. The secured nature of the letter of credit in *FOSTI* was relevant only because release of the security constituted the "new value" received by the debtor there. *See* 837 F.2d at 229-30. Here, Bergner received "new value" in the form of goods and services from AMC and Liberty Mutual. Moreover, Bank One's payments to AMC and Liberty Mutual (required by the letters of credit) were made in "exchange" for Bergner's payments to Bank One (required by the SLCA). Notwithstanding Bergner's attempt to portray the letters of credit and the SLCA as entirely "separate" contracts (Opp. 7), the letters of credit

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[3] As explained in the petition for certiorari (Pet. 14), the court of appeals' first purported distinction of *FOSTI* fails because the intent for AMC and Liberty Mutual to provide new value to Bergner is established on the face of the relevant contracts. *E.g.*, Pet. App. 5a (AMC letter of credit explicitly provides that "proceeds of the accompanying draft will be held and applied against the obligations of [Bergner] to [AMC] as they come due"). As further explained in the petition (Pet. 14-15), the court's second purported distinction fails because Bank One's "new value" defense would in no way frustrate the ability of AMC and Liberty Mutual to draw on their respective letters of credit.

were issued pursuant to, and were governed by, the SLCA. Pet. App. 2a-3a. Thus, all of the payments at issue were the product of a contractual "exchange" under which Bank One agreed to issue and honor letters of credit on Bergner's behalf, and under which Bergner agreed, in return, to pre-fund any draw on those letters. *Id.* Stated differently, all of the payments at issue were in fact causally connected, because all of them resulted from legal obligations mutually undertaken in the SLCA and the associated letters of credit.

In any event, Bergner provides no support for its contention that an "exchange" was impossible because Bank One would have performed its contractual obligations even if Bergner had not performed its obligations. Because the "exchange" term in § 547(c)(1) is undefined, it must be construed to incorporate its meaning in commercial law and contracts, the " 'body of learning from which it was taken.' " *Molzof v. United States*, 502 U.S. 301, 307 (1992), quoting *Morisette v. United States*, 342 U.S. 246, 263 (1952). Under the law of contracts, if A in fact buys a book from B for $10, an "exchange" is present "even though A at the time he makes the offer secretly intends to pay B $10 whether or not he gets the book, or even though B at the time he accepts secretly intends not to collect the $10." *Restatement (Second) of Contracts* § 71, cmt. b, illus. 1 (1981). In other words, the concept of "exchange" does not include the hypothetical, tort-like causation concept that Bergner is forced to invoke here in seeking to defend its unwarranted double-recovery.[4]

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[4] Perhaps anticipating these difficulties, Bergner briefly advances an alternative theory that parties cannot provide "new" value simply by performing on "old" (i.e., existing) contracts. Opp. 13 n.6. The court of appeals did not rest on this

In sum, Bergner concedes that a holding barring application of the "new value" defense where "the value was provided by a third party" would conflict with *FOSTI* and its progeny (Opp. 10) and would raise a "sweeping" and important question of federal law (Opp. 13). Contrary to Bergner's argument, however, the court below rendered exactly such a holding. Bergner's defense of the decision below, asserted to preserve its double recovery of $37 million, rests on alternative and meritless grounds that were not even mentioned, much less adopted, by the court below. This Court should grant certiorari to address the important "new value" question presented.[5]

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theory, which is contrary to circuit precedent and is itself also meritless. *See, e.g., In re Jones Truck Lines, Inc.*, 130 F.3d 323, 325-27 (8th Cir. 1997) (performance on existing employment contracts provided "new value" to the debtor); *In re Powerine Oil Co.*, 59 F.3d 969, 973-74 (9th Cir. 1995) (performance on existing gasoline supply contract and associated letters of credit provided "new value" to the debtor), *cert. denied*, 516 U.S. 1140 (1996); *FOSTI*, 837 F.2d at 228-30 (same).

[5] Because Bergner received future goods and services in exchange for the challenged payments, there was no diminution of Bergner's bankruptcy estate. Accordingly, the transactions at issue did not impair Bergner's other unsecured creditors, and preference law affords no justification for tolerating Bergner's double recovery. *See, e.g., FOSTI*, 837 F.2d at 230 ("The exchange did not result in a depletion of FOSTI's estate, and therefore FOSTI's unsecured creditors were not impaired by this transaction."); Ponoroff, *Evil Intentions and An Irresolute Endorsement for Scientific Rationalism: Bankruptcy Preferences One More Time*, 1993 Wisc. L. Rev. 1439, 1481-82 ("the central theme running through the preference exceptions is return to the transferor of equivalent new value such that, as a result of the transfer, there has not been any net diminution in the aggregate value of the estate available for distribution to general creditors").

2. With respect to the "ordinary course of business" question, Bergner does not dispute that the kind of payments at issue here are "ordinary" in Bank One's dealings with other borrowers, and are "ordinary" throughout the banking industry generally. Therefore, as explained in the petition for certiorari (Pet. 20-30), this Court should decide whether the "ordinary course of business" defense is nonetheless foreclosed by the absence of past similar transactions between Bergner, when it was still financially healthy, and Bank One. Bergner offers no justifiable opposition.

Bergner first contends that the decision below reflects nothing more than a "fact-specific finding" about the ordinariness of the payments at issue in this case. Opp. 8-9, 15. But the court below expressly applied (Pet. App. 21a) the "ordinary course of business" standards established in binding circuit precedent, *see In re Milwaukee Cheese Wisconsin, Inc.*, 112 F.3d 845, 847-48 (7th Cir. 1997), citing *In re Tolona Pizza Prods. Corp.*, 3 F.3d 1029 (7th Cir. 1993), under which the challenged payments must "conform to the norm established by the debtor and the creditor in the period before, preferably well before, the preference period" (*id.* at 1032). As explained in the petition (Pet. 22-23), that exclusive focus on past transactions between the debtor and the allegedly preferred creditor brings the decision below into conflict with cases such as *In re Finn*, 909 F.2d 903, 908 (6th Cir. 1990), which permit consideration of whether the transaction at issue is "out of the ordinary for a person in the borrower's position." Moreover, the court below expressly foreclosed consideration of payments reflecting Bergner's "precarious financial condition." Pet. App. 21a. As explained in the petition (Pet. 23-25), that aspect of the court's holding is at odds with other cases such as *In re Roblin Indus.*, 78

F.3d 30, 42 (2d Cir. 1996), which not only permit, but indeed require, consideration of whether "the terms in question are ordinary for industry participants *under financial distress*" (emphasis added).

Bergner next contends (Opp. 14-15) that *Finn* is inapplicable because that case involved a "debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee" under § 547(c)(2)(A), whereas this case involves a payment "made in the ordinary course of business or financial affairs of the debtor and the transferee" under § 547(c)(2)(B). However, Bergner provides no reason for construing these exactly parallel texts differently; and the reasoning of *Finn* itself – that "every borrower who does something in the ordinary course of her affairs must, at some point, have done it for the first time" (909 F.2d at 908) – applies no less to payments made than to debts incurred. Several lower courts have so recognized, *see, e.g., In re Peterson Distributing, Inc.*, 197 B.R. 919, 925-26 (D. Utah 1996); *In re Morren Meat & Poultry Co.*, 92 B.R. 737, 740 (W.D. Mich. 1988); Pet. 23 & n.8, and Bergner does not distinguish these cases.

Bergner also contends (Opp. 15-16) that *Roblin* is inapplicable because that case involved a debt restructuring agreement. But this contention ignores the broad scope of the Second Circuit's actual holding: " 'ordinary business terms' must include those terms employed by similarly situated debtors and creditors facing the same or similar problems. If the terms in question are ordinary for industry participants under financial distress, then that is ordinary for the industry." 78 F.3d at 42; *see also In re U.S.A. Inns of Eureka Springs, Arkansas*, 9 F.3d 680, 685 (8th Cir. 1993) (similar); Pet. 24-25.

Finally, Bergner contends (Opp. 16) that *Roblin* and *U.S.A. Inns* are inapplicable because those cases involved payments "made according to ordinary business terms" under § 547(c)(2)(C), whereas this case involves payments "made in the ordinary course of business or financial affairs of the debtor and the transferee" under § 547(c)(2)(B). Again, however, Bergner provides no plausible reason why these respective texts should be construed differently; and, as explained in the petition (Pet. 25), the judicial confusion regarding whether to measure ordinariness by reference to healthy or troubled debtors cuts across all of the subsections of § 547(c)(2). Indeed, that confusion would increase substantially if subsections (B) and (C) were distinguished for these purposes, because the boundary between those particular subsections is itself yet another independent source of ongoing judicial confusion. *See, e.g., Milwaukee Cheese*, 112 F.3d at 847; *In re Molded Acoustical Prods., Inc.*, 18 F.3d 217, 223 (3d Cir. 1994); *Tolona Pizza*, 3 F.3d at 1031.[6]

3. Finally, Bergner briefly suggests that neither the "new value" question nor the "ordinary course of business" question is well presented here because, regardless of how this Court might resolve the preference defense issues under § 547(c), the challenged transfers would be setoffs independently disallowable under 11 U.S.C. § 553(b). Opp. 5. That contention is meritless. The court of appeals expressly reserved the question whether the challenged payments are setoffs under § 553(b). Pet. App.

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[6] Bergner's brief suggestion that Bank One waived its "ordinary course of business" defense with respect to the Liberty Mutual transaction (Opp. 8 n.5) is meritless. The court below squarely addressed that defense as to both the AMC transaction (Pet. App. 21a-22a) and the Liberty Mutual transaction (Pet. App. 25a).

25a. If this Court were to reverse the court of appeals on either of the § 547(c) issues, the setoff issue would remain open for decision on remand. To date, the erroneous preference rulings of the court below have deprived Bank One of any appellate consideration of that issue.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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